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SUBJECT: Austrian Banks Take GoA Equity, But More
Funds Available; Mixed Outlook

REF: (A) VIENNA 0365; (B) VIENNA 0060;
(C) 08 VIENNA 1665; (D) 08 VIENNA 1619

11. SUMMARY. Four of the six largest Austrian banks (Erste Bank, Raiffeisen Zentralbank, Volksbanken AG and Hypo Alpe Adria/HAA bank) have now taken equity injections. So far the Austrian government has committed only about one third of the EUR 15 billion reserved for equity participation. Italian-owned Bank Austria plans to start negotiations soon to receive GoA equity; BAWAG, which will disclose a major loss for 2008, is already in negotiations; and nationalized Kommunalkredit (a smaller, specialty lender) will also apply for a GoA injection soon. Finance Minister Josef Proell is convinced that current bank rescue efforts will suffice: if no large Austrian bank fails -- implying that GoA equity injections and state guarantees for interbank lending remain intact -- the GoA would make a tidy profit on its bank rescue, with earnings approaching EUR 300 million per year. However, ratings agencies foresee a deeper collapse in Central/Eastern Europe, which might necessitate more state aid to Austrian banks. END SUMMARY.

The GoA's Equity Facility

12. Austria's October 2008 bank rescue package set aside EUR 15 billion for equity injections to assure solvency of banks and insurance companies. These funds are administered by a new GoA bank rescue holding company Finanzmarktbeteiligung AG (FIMBAG / Financial Market Participation Company -- ref C). All five top Austrian banks initially signaled interest in taking state equity injections, but progress was slow due to late approval by the European Commission, the high cost of taking state equity prior to December 13 (a full six-months interest), and bank resistance to Finance Ministry terms and conditions. Only troubled Hypo Alpe Adria bank (HAA) had accepted state money before December 31; since then, other large Austrian banks (Erste Bank, Raiffeisen Zentralbank and Volksbanken AG) have taken state equity, in each case along with new capital from private shareholders. To date, the GoA has signed equity agreements totaling EUR 5.6 billion, of which EUR 4.6 billion has been disbursed, leaving EUR 9.4 billion is still available.

GoA Conditions for Equity Participation

13. The maximum amount a bank can get from the GoA equity pot is EUR 3 billion, and conditions vary among "sound" and "distressed" banks. From sound banks the GoA stipulates:

-- a market- based interest rate of at least 9.3% (can be reduced to 8% conditional on repayment of 110% of the nominal capital, and if private investors subscribe at least 30% of the total equity injection)
-- dividends to ordinary shareholders are capped at 17.5% of profit before taxes and reserve allocation (not applicable if private investors subscribe at least 30% of the total equity increase).

From distressed banks the GoA stipulates:

-- a market-based interest rate of no less than 10%
-- no dividends can be paid to ordinary shareholders.

The GoA also requires banks receiving state help (via capital participation or a bond guarantee) to lend out twice the amount received to SMEs over the next several years (terms vary).

Hypo Alpe Adria/HAA

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¶4. In late December 2008, HAA got EUR 900 million in GoA capital and received EUR 700 million in fresh equity from its 67% owner, German Bayerische Landesbank/BayernLB (as part of a larger EUR 10 billion Bavarian government package for BayernLB). This equity increase together with the GoA's injection reportedly raised HAA's Tier 1 capital ratio to 8.4%. HAA, which had a troubled record even before 2008, was the Austrian bank in direst need; it has not yet presented its 2008 balance sheet, which is expected to show a substantial loss. Since one of the Bavarian

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government's conditions for supporting BayernLB was a massive cut-back of its international business, BayernLB started implementing a restructuring plan at HAA, which may also involve HAA's withdrawal from some SEE countries.

Erste Bank

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¶5. In late February, Erste Bank signed an agreement with the GoA for an equity injection of EUR 1.9 billion. Erste also plans to raise EUR 800 million via non-voting participation certificates from private and institutional investors. Erste will soon offer these participation certificates (interest rate of 8% until 2014 and then rising to a maximum of the 12-month EURIBOR plus 10%; interest will not be paid in years of a loss or with no dividend payments), but already has reservations for more than half of the volume. The EUR 2.7 billion will push Erste's Tier-1 ratio to about 9.8% from 7.2% at the end of 2008. Erste's 2008 annual report shows a net profit of EUR 860 million (vs. EUR 1.2 billion in 2007).

Raiffeisen Zentralbank (RZB)

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¶6. In early April, Raiffeisen Zentralbank (RZB) signed an agreement with the GoA for EUR 1.75 billion, which will bring RZB's Tier-1 ratio to 10.4% (from 8.4% on December 31). In late 2008, RZB's owners subscribed to an EUR 165 million equity increase and an additional EUR 750 million in equity participation shares. RZB will use some of the equity for its consolidated subsidiary Raiffeisen International/RI which handles the group's CESEE/FSU business. RI is organized as a holding company with no separate banking license and is therefore not directly eligible for state equity. RZB's 2008 balance sheet shows a strong operating profit of EUR 2.8 billion but net profit of only EUR 482 million (down 94% from 2007) due to CEE currency weakness, exposure to Lehman and

Iceland, and an EUR 1.2 billion set-aside in additional loan loss reserves. Subsidiary RI had 2008 net profit of EUR 982 million (2007: EUR 841 million).

Volksbanken, BAWAG, Bank Austria

¶17. In early April, the GoA signed an agreement with Volksbanken AG for EUR 1 billion in state equity. Volksbanken reported a net loss of EUR 152 million for 2008, due to massive write-downs from Lehman, Iceland and Kommunalkredit business (see reftel D). Its Tier-1 ratio at the end of 2008 was 7.6%. Kommunalkredit, which the GoA nationalized in November 2008 (ref C), is expected to apply for a GoA injection once its new business concept and resulting capital requirements are available sometime in May.

¶18. BAWAG has started informal talks with the GoA and will reportedly soon disclose a substantial loss for 2008. BAWAG -- owned by U.S. private equity firm Cerberus Capital Management -- is reportedly sitting on toxic assets in the range of EUR 1 billion, whose status is complicating the state aid process.

¶19. The Italian UniCredit group, with its Austrian subsidiary Bank Austria (BA), reportedly plans to tap government rescue packages in both Italy and Austria for a total of EUR 4 billion. BA would be eligible for a maximum amount of EUR 2.7 billion from the GoA, UniCredit in Italy for 3.8 billion. BA CEO Erich Hampel recently said that BA will start talks on GoA capital, but FinMin Proell said negotiations will first require a commitment from UniCredit to BA's future viability. For 2008, BA reported a net profit of EUR 1.1 billion (2007: EUR 2.3 billion), despite a doubling of provision charges to EUR 1 billion and impairment losses of EUR 1 billion (on goodwill related to CESEE subsidiaries).

Equity Injections - Profit Center for the GoA?

¶10. If none of the banks receiving GoA equity fail, the GoA could make good business out of its rescue

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efforts. Since equity disbursed so far (EUR 4.6 billion) bears an interest rate of 8-9.3% and the GoA's refinancing costs are about 4%, net book earnings for the GoA will be about EUR 200 million annually. In addition, fees for GoA guarantees under the interbank lending facility total about EUR 80 million annually based on the current status of guarantees issued.

GoA Interbank Lending Guarantees also for Industry?

¶11. FinMin Proell recently said that the GoA is considering using EUR 10 billion of the GoA's EUR 75 billion interbank lending guarantee facility (ref A) to guarantee bank loans to industrial enterprises (but not industrial bond issues). The program would address growing complaints from industry about overly stringent bank lending conditions. Proell said the program would offer market-based conditions and would still expose banks to some default risk.

Financial Sector Comments

¶12. FinMin Proell argues that Austria's current banking rescue package will be sufficient, since almost two thirds of state equity pot is still available. In contrast, FIMBAG co-head/ex-Finance

Minister Hannes Androsch is convinced that the EUR 15 billion will soon need to be increased and that the rescue package, devised in October 2008, was based on false optimism regarding the CEE region (Proell rejects Androsch's views).

¶12. Banks publicly express guarded optimism. RZB CEO Walter Rothensteiner sees no problem in repaying the GoA money in five years, since "no crisis lasts five years" (predicting a turnaround within 2-3 years). Erste CEO Andreas Treichl said publicly that the EUR 2.7 billion from the GoA and private investors will suffice and that Erste would only need more equity if the entire CESEE region falls into much deeper crisis.

¶13. Rating agencies continue to cast doubt on the health of major Austrian banks. On April 16, Fitch announced its own stress tests of the largest Austrian banks, concluding that further losses in CEE (and weakness in the Austrian domestic market) will cost the banks most of their existing capital -- and that an "extreme" CEE crisis will essentially wipe out their capital base. Fitch added, though, that Austrian banks are stable based on the continuing ability of the GoA to support them with further measures.

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